

CALIFORNIA STATE LANDS COMMISSION

**ANNUAL STAFF REPORT ON THE MANAGEMENT
OF STATE SCHOOL LANDS**

Fiscal Year 2007-08

CALIFORNIA STATE LANDS COMMISSION

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Submitted to:

Honorable Arnold Schwarzenegger, Governor

The California State Legislature
and
The State Teachers' Retirement System

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INTRODUCTION

The California State Lands Commission (CSLC), through its State School Lands Management Program (Program) manages approximately 469,000 acres of school lands held in fee ownership by the State, and the reserved mineral interests on approximately 790,000 acres of school lands where the surface estate has been sold. Management of the Program is split between two CSLC divisions, the Land Management Division (LMD) and the Mineral Resources Management Division (MRMD). The LMD is responsible for the Surface Management Program under which all surface resources on school lands, with the exception of mineral activities, are administered. The MRMD is responsible for the Geothermal, Mineral, and Oil & Gas Programs, which involve the leasing of school lands for geothermal resources development, mining activities, and oil and gas development.

School lands were placed into a statutory trust in 1984 when the State Legislature approved the School Land Bank Act (Act), created the School Land Bank Fund (SLBF), and designated the CSLC as trustee of the SLBF. The Act added Sections 8700 through 8716 to the Public Resources Code (PRC), which set forth the management guidelines for the Program. The Act directs that school lands be proactively managed and enhanced to provide for an economic base in support of the public school system. PRC Section 8702 spells out specific findings and declarations made by the Legislature, emphasizing the development of school lands into a permanent and productive resource base and requiring that all transactions, including exchanges, sales, and acquisitions, be implemented for revenue generating purposes.

Pursuant to PRC Section 6217.7, all net revenues, monies, and remittances from the sale of school lands are deposited into the State Treasury to the credit of the SLBF. PRC Section 6217.5 directs all net revenues derived from the use of school lands (i.e., royalties, rents, and interest generated from promissory notes) be deposited into the State Treasury to the credit of the Teachers' Retirement Fund, which benefits the State Teachers' Retirement System (STRS).

The CSLC's emphasis in administering the Program has been: 1) the maximization of revenues from school lands assets, 2) the continued implementation of the California Desert Protection Act Exchange Program, and 3) protecting the corpus of the trust.

Net revenue transferred to STRS during Fiscal Year 2007-08 was \$6,393,572.40, which represents an increase of 11.8% over the prior year net revenue. Management expenses for the Program in FY 2007-08 totaled \$1,020,934.27, which represents a 9.4% increase from FY 2006-07 expenses. Net revenue deposited to the SLBF was \$2,524,135.28, resulting in a fiscal year end balance of \$59,626,639.28. For a summary, see the table entitled "Financial Summary: Fiscal Year 2007-08" (page 28).

The *Annual Staff Report on the Management of State School Lands* is prepared pursuant to PRC Section 6477. The major activities for each of the Program components for FY 2007-08 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The Land Management Division is responsible for the Surface Management Program, which oversees all surface activities on school lands with the exception of mineral activities. These activities include land exchanges and sale of school lands parcels to public and private entities, acquisitions of lands to enhance the resource base, and the issuance of leases for various purposes such as agricultural, grazing, and rights of way for roads, oil and gas pipelines, and electrical transmission lines. The objectives of the Surface Management Program are to manage surface uses to generate revenue, assure ongoing viability of the resource, protect the corpus of the trust, enhance local economies, and protect the environment. These goals are accomplished through management and development techniques that maximize the economic return to STRS and the SLBF. For a summary of the revenues generated to STRS and the SLBF through the Surface Management Program, see the table entitled "Summary of Revenue Generated From Surface Management Program: Fiscal Year 2007-08" (page 6).

FISCAL YEAR 2007-08 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rental Income and Revenues

The majority of the 469,000± acres of school lands are isolated, landlocked parcels, with many being non-productive desert lands. However, close to a quarter of the total school land acreage is leased for revenue generating purposes. Revenues deposited into the STRS fund from approximately 140 revenue-generating leases in FY 2007-08 totaled \$201,233.30, which represented an increase of 40% over FY 2006-07. General surface leasing involves ongoing activities, including processing new applications, re-issuing expired leases, processing lease assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities.

SCHOOL LAND BANK FUND REVENUES AND EXPENSES

A total of \$2,524,135.28 in net revenue was generated to the SLBF during FY 2007-08. This includes principal revenue of \$255,150.00 from two land sales and a land exchange described below plus total accrued interest of \$2,530,138.21, less expenses of \$261,152.93.

Pit River Tribe Land Sale (SA 5762)

In March 2008, a 27.156-acre parcel of land in Modoc County was sold to the Pit River Tribe. The transaction was completed to facilitate reconstruction of Lauer

Dam, a project of the Bureau of Indian Affairs and the Bureau of Reclamation. The transaction resulted in a deposit of \$8,150 into the SLBF.

Sallis Land Sale (SA 5764)

In March 2008, a 17,028± square foot parcel of land in San Bernardino County was sold to Robert and Cheryl Sallis, and resulted in a deposit of \$22,000 into the SLBF.

White Cloud Resources Land Exchange (AD 528)

In April 2008, staff completed a land exchange in Mendocino County with White Cloud Resources. The transaction resulted in a deposit of \$225,000 into the SLBF.

Accrued Interest on the School Land Bank Fund

The total interest accrued on the SLBF during FY 2007-08 was \$2,530,138.21. Interest accruals decreased 10.5% from the previous year due to the lower interest rates that resulted from a general downturn in economic conditions.

Expenses Charged to the School Land Bank Fund

Expenses charged to the SLBF during FY 2007-08 totaled \$261,152.93. The majority of these expenses (86%) were attributable to an abandoned mine closure program (see Abandoned Mine Lands, pages 18 and 24). Additional expenses (13%) accrued pursuant to work on unexploded ordnance on school lands in the southern California desert (see Potential Hazards on School Lands, page 9). The remainder of the expenses (1%) resulted from charges paid to the 21st Century Project, a new state-wide effort approved by the Legislature to modernize California's Human Resources system (for more information, see <http://www.21stcentury.ca.gov/index.shtml>).

UPDATE: CALIFORNIA DESERT PROTECTION ACT OF 1994

On October 31, 1994, the California Desert Protection Act (CDPA) was signed into law by the President of the United States (Public Law 103-433). The CDPA designates 3.6 million acres in southern California as wilderness to be administered primarily by the Bureau of Land Management (BLM), and designates an additional four million acres in southern California to be included in the national park system. The purpose of the CDPA is to preserve areas in the California desert to protect its natural, cultural, scenic, and historical values and to provide for public enjoyment. Four hundred forty-two parcels (approximately 251,000 acres) of fee-owned school lands and over 100 parcels encumbered by the State's reservation of mineral interests have been identified to be within the boundaries of the CDPA.

Section 707 of the CDPA provides for the exchange of the school lands located within these designated areas for other federal lands located outside of these areas. The CSLC receives compensation for the exchange of its fee and mineral interests on a value-for-value basis as determined by fair market appraisals. Compensation for the State's assets may be made in various forms including cash or exchange for other lands. To date, there have been five CDPA land exchange transactions completed with the BLM. These five exchanges have resulted in the transfer of over 66,000 acres of school lands to the BLM and deposits totaling over \$14.7 million into the SLBF.

During FY 2007-08, work continued on a sixth CDPA land exchange. In the prior year, staff found that an appraisal of 107 parcels of school lands prepared by an independent appraiser for the Department of the Interior's Appraisal Services Directorate (ASD) was inadequate and unacceptable. Staff subsequently entered into negotiations with the ASD in an attempt to reach an acceptable estimate of market value for the subject properties. These negotiations resulted in the conclusion that a second appraisal would be prepared and that staff of the CSLC would contract for its own appraisal of the subject properties. During FY 2007-08, staff issued a Request for Proposals (RFP) for the new appraisal. The RFP process and the contract for the new appraisal were completed late in the year. The sixth CDPA land exchange is now expected to be completed in FY 2008-09.

At the close of FY 2007-08, there were 326 parcels of school lands containing a total of approximately 185,400 acres within the designated national parks, monuments, preserves, and wilderness areas available for exchange with the BLM.

SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM - FISCAL YEAR 2007-08

STRS FUND

Surface Rentals:

Surface Rentals:	\$ 201,233.30
TOTAL GROSS REVENUE GENERATED TO STRS FUND:	\$ 201,233.30

SCHOOL LAND BANK FUND

GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 2,785,288.21
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EXPENSES

Program 10 – Abandoned Mine Closure Program:	\$ 225,078.69
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Program 20 – Unexploded Ordnance:	\$ 34,007.54
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21st Century Fund:	<u>\$ 2,066.70</u>
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TOTAL EXPENSES CHARGED TO SCHOOL LAND BANK FUND:	\$ 261,152.93
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NET REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 2,524,135.28
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FISCAL YEAR 2008-09 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rentals Income

Staff estimates surface rental will exceed \$200,000 for FY 2008-09 from existing and new surface use leases on school lands parcels.

Income from Timber Harvests

There is potential for income from timber salvage and sanitation operations in FY 2008-09. These operations are conducted periodically due to losses from natural causes such as fire, high winds, insect infestation and diseases. Because of the irregular nature of these operations, the amount of additional income from these sources is difficult to predict.

Alternative Energy Projects

With the rise in energy prices and increasing public awareness about global warming, staff expects more interest in the long-term leasing of school lands for alternative energy projects. Some such projects will involve utilization of wind as an energy source. These projects require the installation and operation of wind turbines that if installed, would generate electricity that would be placed into the State's electrical grid. Other alternative energy projects will utilize solar technology such as photovoltaic cells and solar-concentrating systems (troughs, towers, or dishes).

Staff plans to continue processing two applications for wind energy leases received last year. These proposed projects, located in Kern and San Diego counties, are currently in the planning stage and must undergo a review pursuant to provisions of the California Environmental Quality Act (CEQA). Staff also anticipates inquiries regarding the availability of school lands in San Bernardino and Imperial counties for wind energy projects, but no applications for such leases have yet been received on these properties.

Staff will continue processing two applications for solar energy leases in San Bernardino County that together would cover nearly 11,000 acres. The two proposed projects will be subject to an environmental review under the CEQA.

POTENTIAL SCHOOL LAND BANK FUND REVENUES AND ACTIVITIES

Applications for the following projects are currently under consideration and will be actively processed in FY 2008-09. Staff also anticipates that new requests for land exchanges and land sales will be received throughout the year.

CDPA/Bureau of Land Management Land Exchange (W 24480/AD 407)

Prior CDPA land exchanges between the CSLC and the BLM have resulted in an unequal balance between the values of the lands previously exchanged. Currently, the CSLC owes the BLM lands worth \$2,081,775. Additionally, the BLM has available, through the General Services Administration, approximately \$6,500,000 from surplus federal land sales that is designated for CDPA land purchases from the CSLC. Staff has been working with the BLM on a new proposed "Ledger Balancing Land Exchange", whereby the CSLC will transfer school lands of approximately \$8,500,000 in value to the federal government in order to eliminate the outstanding balance and facilitate the completion of the terms of the original CDPA legislation. When completed as proposed, staff anticipates that approximately \$6,500,000 will be deposited into the SLBF.

State Parks – Ocotillo Wells SVRA Expansion Land Sale (SA 5763)

The California Department of Parks and Recreation (State Parks) submitted an application in FY 2005-06 to purchase 5,758 acres of school lands for the expansion of Ocotillo Wells State Vehicle Recreation Area (SVRA). The land consists of nine full sections in Imperial County. State Parks recently completed an acquisition involving 4,000 acres of privately-owned land for the expansion, and the nine sections of school lands are arranged in a checkerboard pattern amid this recently acquired property. The proposed sale is currently on hold as State Parks contracts for environmental and cultural resource surveys for a new General Plan that will be prepared as part of State Parks' expansion.

The Nature Conservancy Land Sale (SA 5765)

The Nature Conservancy (TNC) submitted an application in FY 2007-08 to purchase 640 acres of school lands in Inyo County, which it intends to donate to the BLM for inclusion in an existing Area of Critical Environmental Concern. This sale was approved by the CSLC late in FY 2007-08, and is scheduled to close in August 2008. Upon the completion of this sale, \$640,000 will be deposited into the SLBF.

New Investments – Agricultural Land and Ground Leases

Staff will continue to research potential new investments for SLBF monies in FY 2008-09, concentrating on agricultural lands and ground leases that maximize potential revenues while minimizing management expenses. Staff also will work with the STRS real estate staff to explore methods for utilizing the expertise and resources of a larger investment fund with mutual investment goals.

Potential Hazards on School Lands

Staff will continue to work with the U.S. Army Corps of Engineers to pursue the remediation of potential hazards on some school land parcels in remote desert locations used by the U.S. military for training purposes during World War II. The military activities included artillery practice, bomber training and tank warfare using live ammunition. With the increasing use of desert lands by the public for off-road vehicle activities and other recreational purposes, concerns have been raised about the potential liability to the State and the SLBF posed by possible unexploded ordnance on these lands. In 2006, the Legislature and the Governor authorized funding for a report analyzing potential hazards on school lands, including unexploded ordnance, and a plan for addressing these potential issues. The report was delivered to the chairs of the appropriate policy and fiscal committees in both houses of the Legislature in January 2008.

GEOHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS

The MRMD is responsible for the Geothermal, Solid Minerals, and Oil & Gas Programs, which involve leasing and managing school lands for the development of geothermal energy, mining activities, and oil and gas operations. These programs strive to maximize royalty revenue while protecting the environment and assuring public safety. Revenue generated from these programs benefit the State Teachers' Retirement System (STRS).

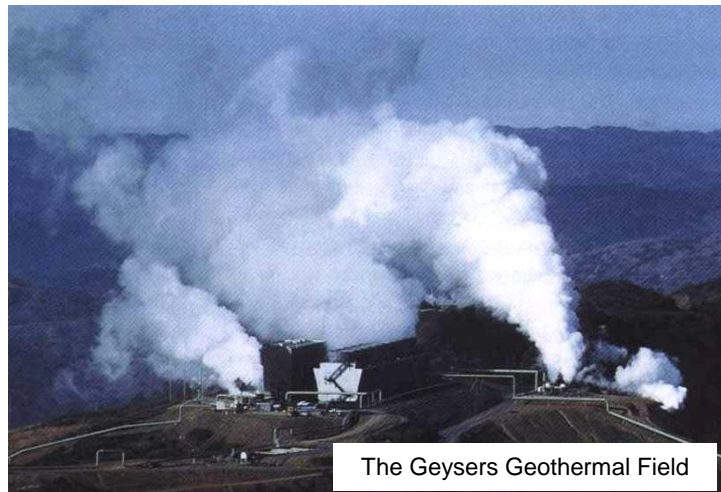
FISCAL YEAR 2007-08 ACTIVITIES

GEOHERMAL PROGRAM

Revenue from the geothermal program totaled \$6,267,779.66 for FY 2007-08, a 13% increase over the prior year. All the revenue is from the production of steam on school lands leases at The Geysers geothermal field. Actual production decreased by 3% from the prior year, but the value of the steam increased by 25%, reflecting higher prices for the electricity generated from the steam.

Geothermal Leases at The Geysers

The Geysers field in Sonoma and Lake Counties is the site of the world's largest geothermal energy development. The State now has 6,848 acres of 100% reserved mineral interest school lands under lease there, plus 360 acres of 1/16th reserved mineral interest school lands that are productive. The State acreage provides about 25% of the steam used to generate nearly 1,000 megawatts of electricity. The balance of the steam is produced from adjacent Federal and private leases.



The Geysers Geothermal Field

Geysers Power Company LLC (Geysers Power) owns and operates most of the steam field and associated generating facilities, and is the lessee of all six of the State's geothermal leases. In January 2008, Geysers Power and nearly 200 other subsidiaries owned by Calpine Corporation emerged from the Chapter 11 bankruptcy protection filed in December 2005. During the bankruptcy and restructuring process, Geysers Power continued its geothermal operations with no curtailment of steam production or electrical generation, and continued to pay

all royalties due under the terms of its State geothermal leases. Since emerging from bankruptcy, Geysers Power has begun expanding its operations.

In September 2007, the CSLC approved an amendment deferring the drilling obligation on a 1,881-acre lease issued to Geysers Power in 2004. Drilling operations must now begin by September 2009. The amendment also provided for an increased annual rent until the lease becomes productive. In June 2008, the CSLC approved another amendment for that same lease that grants Geysers Power the right to drill two additional exploratory wells. The lessee now has authority to drill five exploratory wells, and more than two dozen development wells from certain permitted drill sites. Drilling operations are expected to begin in the coming year. Depending on the results of exploratory drilling and the ability to secure new power sales contracts, Geysers Power hopes to construct one or more new generating facilities in the northwestern part of the field or increase the steam supply to its existing plants. Much of the development would involve the State lease.

Staff continued processing an application submitted by Geysers Power in October 2006 for a lease (no surface use) on 400 acres of reserved mineral interest school lands in the northwest part of the field. Negotiations on the terms of that lease were underway when staff was advised in January 2008 of Geysers Power's desire to revise the application to include surface use and a new plan of development. The new proposal will require further review by staff and a conditional use permit from Sonoma County. The review and permit process are underway and will likely take several months to complete.

In March 2008, the CSLC approved an amendment to the largest geothermal lease at The Geysers, increasing its size by 158 acres to more than 2,700 acres. The newly added fee interest school lands had been part of an older Federal geothermal lease that the State acquired in 1983, but which had been unproductive since 1994. Geysers Power agreed to surrender that older lease and add a portion of the lands to an adjacent State lease. The amendment requires that Geysers Power drill into the lands within six months and pay a significantly higher annual rent until the lands become productive. In June 2008, staff approved the drilling program for a new well that will be drilled into the newly added lands.

Geothermal Prospecting Permit

In March 2008, the CSLC approved a two-year extension to a geothermal prospecting permit issued to Deep Rose LLC in April 2006. The permit covers a 640-acre parcel in Inyo County several miles north of the Coso geothermal field. The permit grants an exclusive right to prospect for geothermal resources, and a preferential right to a lease upon discovery of resources in commercial quantities. The extension was needed because the permittee has had difficulties finding a financial partner, a drilling contractor, and securing all the permits

required for the construction of an access road and commencement of exploratory drilling. The CSLC also approved an assignment of the permit from Deep Rose to a new partnership called Deep Rose Geothermal 16 LLC that includes Deep Rose and Raser Technologies, the latter bringing financial resources and technical expertise to the partnership. The permit cannot be extended a second time, so it will expire at the end of April 2010. If the permittee discovers a commercial resource before then, staff will negotiate terms and recommend the CSLC issue a geothermal lease.

Geothermal Prospecting Permit Applications

Staff continued processing three applications for geothermal prospecting permits covering 4,485 acres of school lands north of the developed portion of The Geysers. The applications were submitted by three subsidiaries of U.S. Renewables Group in May 2007 and were initially held in abeyance while staff examined the suitability of offering the lands for lease by competitive public bid. Staff published a notice to the geothermal industry advising that school lands may be available for possible competitive leasing, but when no company was willing to nominate lands for leasing, staff resumed processing the applications.

Staff met with the Applicants and representatives of the California Division of Oil, Gas, and Geothermal Resources (CDOGGR) and the County of Lake to discuss the proposed exploratory drilling. The CDOGGR will be the lead agency for the analysis required under the CEQA. The CSLC and Lake County will each be a Responsible Agency. The CSLC will use the environmental documentation as the basis for issuing prospecting permits, while the County will use it for issuing conditional use permits. The three applications remain incomplete pending submittal by the Applicants of detailed prospecting plans for staff review. The environmental analysis and approval of the prospecting plans must occur before staff can make a recommendation to the CSLC that prospecting permits be issued.

Two other applications for geothermal prospecting permits, submitted in 2001 by Mack Energy Co. and Layman Energy Associates, remain incomplete. The applications cover 3,034 acres of school lands west of the Salton Sea in Imperial County in an area known as Truckhaven, some of which lie within the boundaries of the Ocotillo Wells State



Vehicular Recreation Area. Staff intends to seek CSLC approval to terminate the applications and instead offer the lands for lease by competitive public bid.

Nomination for Competitive Bid Lease Sale

In January 2007, Ormat Nevada, Inc. submitted a formal nomination covering 2,394 acres of school lands it proposes be offered for leasing by competitive public bid in the Truckhaven area of Imperial County. The nomination covers most lands within the two applications discussed above. Staff intends to recommend an additional 1,240 acres of school lands be added to those nominated by Ormat, for a total of 3,634 acres to be offered for leasing. Ormat has agreed to provide funding to cover the environmental review and staff time related to conducting a competitive lease sale.

The BLM prepared a programmatic Environmental Impact Statement (EIS) for the leasing and development of 14,731 acres of Federal lands in the Truckhaven area. The EIS actually covered a 40,320-acre area that includes BLM, State, and private lands, all interspersed in a checkerboard pattern. The BLM intends to issue non-competitive leases on some Federal lands and hold a competitive bid lease sale on others, while the CSLC would conduct a competitive bid lease sale on the school lands parcels. In March 2008, the CSLC approved a solicitation for a consultant to prepare environmental documentation and mitigation monitoring to supplement the BLM's EIS so that the requirements of the CEQA can be satisfied prior to the CSLC conducting a lease sale.

Staff is working closely with State Parks because most of the Truckhaven area is within the boundaries of its Ocotillo Wells SVRA. Such cooperation is critical so that geothermal exploration and development does not interfere unreasonably with use of the lands for recreation.

SOLID MINERALS PROGRAM

Revenue from the solid minerals program totaled \$397,870.41 for FY 2007-08, a 35% decrease from the prior year. The decrease can be attributed to reduced demand for aggregate caused by a downturn in the real estate market related to problems in the subprime mortgage industry. All three of the State's aggregate producers had decreased sales during the year.

The solid minerals program currently manages six mineral leases totaling 1,188 acres, one active 1/16th reserved mineral interest parcel totaling 560 acres and one mineral prospecting permit near Bodie encompassing 480 acres. In addition to overseeing these mineral properties, staff continued processing applications for three new mineral leases, and began processing applications for two new mineral prospecting permits.

Mineral Lease Management

U.S. Borax (PRC 736)

U.S. Borax, Inc. (USB) submitted a quitclaim deed in February 2007 for its 160-acre mineral lease at the Gerstley mine near the town of Shoshone, southeast of Death Valley in eastern Inyo County. The lease was one of the first solid mineral leases issued by the State, dating back to the 1920s. Operations at the underground mine were idled in 1999 when it no longer met Federal Mine Safety and Health



Bat-compatible gate,
Gerstley Mine, Inyo Co.

Administration construction standards. All mine openings were sealed in 2005 for public safety, and two bat-compatible steel gates and two steel grates on air shafts were installed. An inspection of the underground workings of the mine was conducted in November 2007 which revealed minor amounts of lubricant and fuel oil which subsequently were disposed of properly by USB. Staff met in April 2008 with the Inyo County Planning Department, the Department of Conservation Office of Mine Reclamation (OMR), and USB to ensure all environmental and reclamation requirements would be met prior to CSLC consideration of the quitclaim deed. OMR indicated that additional earthwork and revegetation was required. In June 2008, staff received notice from USB that the earthwork would commence. Another inspection with Inyo County, OMR and USB will be needed to ensure full compliance.

Hanson Aggregates (PRC 7301)

Hanson Aggregates (Hanson) continued aggregate operations from its 120-acre lease near Lakeside in northern San Diego County. Revenue from the lease increased slightly for the year, totaling \$272,415.22. Given the state of the housing industry, the modest increase was commendable.



Lakeside Quarry,
San Diego Co.

Homestake Mining (PRC 7808)

In 1994, amidst an ownership dispute, the CSLC issued Homestake Mining Company (Homestake) a 305-acre lease in Yolo and Napa counties within its 10,000-acre McLaughlin Gold Mine. The Federal Interior Board of Land Appeals subsequently ruled in favor of the State in that dispute. Homestake explored the leased land through a series of shallow drill holes adjacent to its active gold mine, but did not

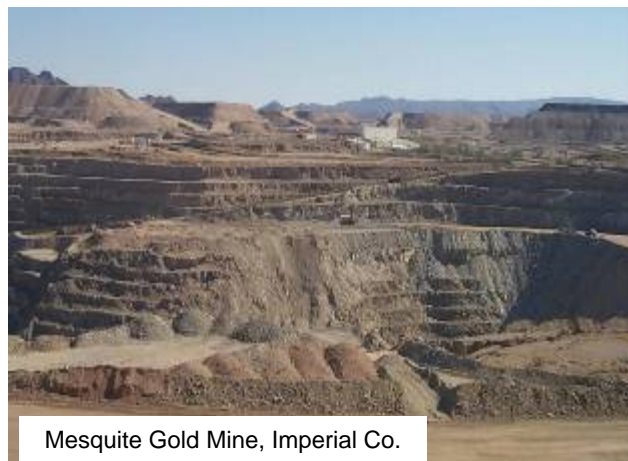


McLaughlin Mine,
Yolo and Napa Cos.

discover economic mineralization. However, Homestake used the property to stockpile low-grade gold ore, which was later removed and processed when the mine closed a few years ago. In June 2007 staff inspected the site to evaluate reclamation work in advance of the CSLC considering acceptance of a quitclaim deed. Staff has requested verification letters from Yolo and Napa counties, lead agencies under the Surface Mining and Reclamation Act of 1975, as well as the Regional Water Quality Control Board, that reclamation is complete prior to consideration by the CSLC. Homestake anticipates approval of a revised closure plan in 2009 that will include the State lease. In 2003, Homestake entered into a Memorandum of Agreement with the U.C. Regents to use most of the non-mined property as a nature reserve, with a purchase option. Homestake has indicated that continued surface use of the property will be needed following acceptance of the quitclaim deed to operate a water pipeline and electrical transmission line, possibly under a separate surface use agreement. A meeting will be scheduled to discuss continued use of the surface following acceptance of the quitclaim deed for the mineral lease.

Western Mesquite Mines (PRC 8039)

Western Mesquite Mines, Inc. (Western Mesquite) holds a 658-acre lease north of the existing Mesquite Mine Big Chief Pit in a remote area of Imperial County. Most of the mine property is located on BLM land and patented mining claims. Mining operations ceased in 2001 due to gold prices dipping below \$300 per ounce and the depletion of permitted reserves. Since then, gold prices

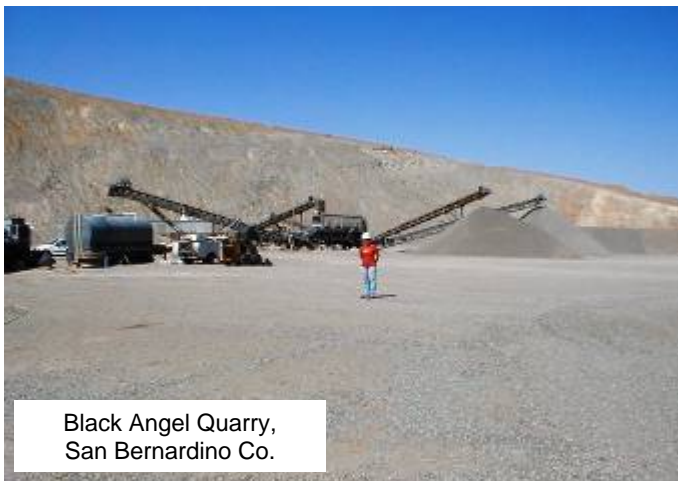


Mesquite Gold Mine, Imperial Co.

have tripled to about \$900 per ounce. Imperial County approved a mine expansion plan that includes the extraction of gold ore from the State lease. Western Mesquite resumed mining in FY 2007-08 with the acquisition of two new 50-ton capacity shovels and 14 200-ton capacity trucks. The current mining rate is 165,000 tons per day on land immediately south of the State lease. Employees increased from 40 in January 2007 to 210 currently, with 65% of those residing in California. Mining on the State lease is anticipated to commence in 2010.

Sigma Stone (PRC 8253)

Sigma Stone Co. (Sigma) has operated the Black Angel Quarry on a 160-acre State lease in a remote desert site several miles south of Barstow in San



Bernardino County. Sigma extracted, crushed, and screened volcanic rock to produce various aggregate products that it sold for road building, landscaping, and construction. In March 2008, the CSLC approved assignment of the lease from Sigma to Vulcan Lands, Inc. (Vulcan), the largest aggregate producer in the nation. The lease was also amended to provide for a higher royalty and

production rates and bonding. Vulcan has plans to increase production markedly. Revenue from the lease decreased to \$66,405.39 for FY 2007-08, down 66% from the prior year due to housing and infrastructure challenges.

Protech Minerals (PRC 8322)

Protech Minerals, Inc. (Protech) retains a ten-acre lease at the Pioneer Talc Mine located in the Kingston Mountains in northeastern San Bernardino County. The resource consists of a natural deposit of the mineral talc. The mine remained idle during the year, but operations should be reactivated when the domestic market for talc improves. Foreign competition makes domestic production economically



challenging. A total of \$3,300 was received for the annual minimum royalty. Staff completed an inspection of the site in April 2008 and found that a disabled bulldozer had been removed, but that no significant mining had occurred. The current five-year lease term will be up for renewal in April 2011.

Granite Construction, Ludlow Pit (PRC 8272)

Granite Construction Co. (Granite) holds an 80-acre lease near the community of Ludlow in San Bernardino County. The sand and gravel mine is located within one mile of Interstate 40 making it an ideal source of raw materials for repaving work. The mine is currently idled, but Granite hopes to be the successful bidder on a road construction contract for a portion of Interstate 40 in the near future.

A minimum annual royalty of \$17,100 was received for the lease.



Granite Construction, Palm Desert Pit (PRC 7945)

Granite extracts sand and gravel from a large open pit mine near Palm Desert in Riverside County, which includes a 560-acre parcel where the State owns a 1/16th reserved mineral interest. The State's royalty is fixed at \$0.04 per ton of material mined. Revenue from the parcel totaled \$38,649.80 for the year, a 36% reduction from the prior year and attributable to a pullback in construction in the Palm Springs and Coachella Valley region served by the mine.

Jacobson Construction (W 40783)

Jacobson Construction (Jacobson) mines sand and gravel in an area west of the community of Baker in San Bernardino County. The current mining operations approved by San Bernardino County in October 2002 include State lands with a 1/16th reserved mineral interest. Staff is seeking compensation for the mineral extraction that occurred during the past several years on lands with the State mineral interest.



Mineral Prospecting Permits

Southern Clay Products (PRC 8571)

Southern Clay Products (SCP) had held a two-year mineral prospecting permit on a parcel of school lands in Amargosa Valley, a remote area of Inyo County east of Death Valley. SCP owns the surface, but the subsurface minerals are owned by the State. The permit expired in October 2006. A site inspection by staff in April 2008 confirmed that SCP never conducted the permitted drilling exploration program approved by Inyo County. As such, the file for this permit has been closed.

Cougar Gold LLC (PRC 8742)

In March 2008, the CSLC issued a one-year extension to a mineral prospecting permit held by Cougar Gold LLC (Cougar). The permit gives Cougar the right to explore for minerals on a 480-acre parcel in a remote area of Mono County northeast of Bridgeport. Exploratory work is limited to geologic mapping and rock chip sampling. The parcel is in a mineralized belt that may be rich in precious metals. During the summer and fall of 2008, Cougar plans to conduct further field work to verify and delineate the mineralization and to determine if drilling is warranted. Any proposed drilling would require approval by the CSLC.

Mineral Lease Applications

Granite Construction, Liberty Quarry Project (W 40904)

Staff continued processing an application initially submitted in December 2004 by Granite for a negotiated lease on a 160-acre parcel south of Temecula in Riverside County. An adjacent 151-acre parcel where the State retains a 1/16th mineral interest will also be included. A proposed mine, designated the Liberty Quarry, is in the permitting stages for the extraction of granitic rock that will be crushed to provide aggregate. A draft Environmental Impact Report (EIR) is due out in the summer of 2008. In June 2008, staff attended an open house hosted by Granite to present information on the proposed quarry. The proposed quarry will have an anticipated life, including reclamation, of 80 years. Potential royalty revenue to the State is estimated to easily exceed \$100 million.



In March 2008, staff became aware that the city of Temecula planned to annex and preserve as open space 4,279 acres that would include the land proposed to be used by the Liberty Quarry. After reviewing the draft EIR for the annexation plan, two letters expressing concern were mailed to the City and other relevant parties. The Riverside County Local Agency Formation Commission is expected to deny the city of Temecula's annexation plan.

Bureau of Reclamation (PRC 6735)

The U.S. Department of Interior, Bureau of Reclamation (BOR) filed applications in April 2000 with the CSLC and San Bernardino County to reactivate the



Manchester Quarry located on a State parcel in a remote area of the Colorado Desert, several miles west of the California-Nevada border. Rock material from the quarry would be used to armor levees of the Colorado River to protect life and property. The BOR needs rock sources in close proximity to the Colorado River to reduce environmental impacts and transportation

costs. The BOR intends to extract a minimum of 2.8 million tons of rock over a 25-year period. A meeting was held in April 2007 with the BOR, San Bernardino County, Office of Mine Reclamation, and CSLC staff to discuss items needed to move the project forward. In January 2008, staff provided additional information requested by the County. The OMR has completed biologic studies and a Mining and Reclamation Plan for the proposed project. San Bernardino County is currently awaiting the completion of a Slope Stability Study from the OMR.

Hi-Grade Materials (W 40842)

In 2005, Hi-Grade Materials Co. (Hi-Grade) applied for a negotiated lease to expand an existing sand and gravel pit in Lucerne Valley in San Bernardino County, north of Big Bear. Hi-Grade intends to extract aggregate resources from a 113-acre school lands parcel, and alleviate an excessively steep slope that currently exists on the south wall of the pit which does not meet County



requirements. The County is finalizing its conditional use permit for the mining and reclamation plan associated with Hi-Grade's expansion. Staff is currently negotiating lease terms in preparation for consideration by the CSLC.

Mineral Exchange Application

Kaiser Resources (W 40871)

Kaiser's application to exchange the State's reserved mineral interest on a 467-acre parcel for a partial interest in a nearby mineral estate owned by Kaiser remained in abeyance. The parcel is within the Eagle Mountain Mine Complex, an open pit iron ore mine in Riverside County that last operated in 1982. The CSLC had issued a lease to Kaiser in 1978 covering 145 acres. The lease expired in 2002. Kaiser subsequently permitted a landfill at the site, which will be sold to the Los Angeles Sanitation District. Work on the proposed exchange has been suspended pending a ruling by a Federal District Court on a land exchange between Kaiser and the BLM. In April 2008, staff gave verbal testimony on impacts to the State mineral resource from a proposed "Eagle Mountain Pumped Storage Project" which would involve pumping water uphill at night to an upper reservoir and allowing it to flow through turbines to a lower reservoir and generate up to 1,300 megawatts during the day when electrical demand is higher. In June 2008, written comments were provided to the company facilitating the project, GEI Consultants, Inc.



Mineral Prospecting Permit Applications

CPX Uranium, Inc. (W 40942)

In April 2008, CPX Uranium, Inc. (CPX) submitted an application for a mineral prospecting permit on two adjoining parcels totaling 837 acres in a remote area near the western edge of the Coso Mountains in Inyo County. These parcels contain deposits of uranium ore that previously were explored in the 1960s. CPX plans to conduct geologic mapping, rock chip sampling, surveying and the geophysical logging of old exploratory wells that have existed on the property since the early assessment work. In June 2008, staff advised CPX its application was incomplete pending submittal of additional information, required fees, and a deposit to cover processing. CPX is a corporation headquartered in Apache Junction, Arizona.

Victory Mining and Exploration LLC (W 40943)

In May 2008, Victory Mining and Exploration LLC (Victory) submitted an application for a mineral prospecting permit on a 640-acre parcel in the Shadow Mountains, a remote area of the Mojave Desert in San Bernardino County. Victory plans to conduct geologic mapping and rock chip sampling to delineate the extent of a gold-mineralized zone within the parcel. In June 2008, staff advised Victory its application was incomplete pending submittal of additional information, required fees, and a deposit to cover processing. Victory is a corporation located in Las Vegas, Nevada.

Abandoned Mine Lands

The CSLC began a cooperative effort with the OMR in 2002 to inventory and remediate abandoned mine features on school lands. A Memorandum of Understanding remains in effect until April 2009. Of the SLBF's 1,200 fee-owned parcels, there are at least 141 that contain nearly 750 individual mine features. In fall 2007 CSLC staff has seven hazardous shafts backfilled on a parcel in the Calico Mountains, two at the



Backfilling a shaft, Fry Mts.,
San Bernardino Co.

Trade Rat Mine north of Barstow, three shafts in the Fry Mountains, and one shaft that was closed with a polyurethane foam plug at the Los Padres Mine. In Kern County one prospect shaft was backfilled near the Standard Hill Mine, near Mojave. All of this closure work was done after performing surveys to avoid adverse impacts to wildlife and historic resources. In February 2008, staff helped the National Park Service (NPS) install a bat gate at the Riverview Mine on BLM lands in the Whipple Mountains of San Bernardino County. The CSLC is considering working with the NPS at Joshua Tree National Park to close mine features at the Golden Bee Mine complex which straddles State and Federal lands.

OIL & GAS PROGRAM

Revenue from the oil & gas program totaled \$640,643.52 for FY 2007-08, a 56% increase from the prior year. Oil production increased by 5% on the two school lands parcels where the State has a 1/16th reserved mineral interest. The average oil price increased by 50% over the prior year, reaching \$114.88 per barrel for May 2008 production. The vast majority of the revenue, \$637,984.24, came from the 160-acre Round Mountain parcel (VA 5310) located northeast of Bakersfield in Kern County. The parcel is part of a unit operated by MacPherson Oil Company. The balance of the revenue, \$2,659.28 came from the seven-acre Sulfur Crest parcel (LA 9252) located in the Ojai oil field in Ventura County.



REFERENCE MAP FOR PARCELS ASSOCIATED WITH GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS



**SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL,
SOLID MINERALS, AND OIL & GAS PROGRAMS -
FISCAL YEAR 2007-08**

STRS FUND

Geothermal Royalties:

Royalties from producing leases:	\$ 5,858,808.13
Royalties from 1/16 th agreement parcel:	\$ 14,297.27
Supplemental Royalty from one lease:	\$ 394,674.26
Geothermal Total:	\$ 6,267,779.66

Solid Minerals Royalties:

Royalties from leases:	\$ 359,220.61
Royalties from 1/16 th agreement:	\$ 38,649.80
Solid Minerals Total:	\$ 397,870.41

Oil & Gas Royalties:

Oil & Gas Total:	\$ 640,643.52
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TOTAL GROSS REVENUE:	\$ 7,306,293.59
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FISCAL YEAR 2008-09 PLANNED ACTIVITIES

GEOTHERMAL PROGRAM

The Geysers

Staff estimates revenue from school lands geothermal leases at The Geysers will reach \$6 million in FY 2008-09. Steam production is expected to remain stable and prices for electrical power are expected to remain strong. Staff will continue processing Geysers Power's application for a negotiated lease on 400 acres of school lands at The Geysers. Staff also anticipates receiving one or more drilling proposals from Geysers Power on its existing leases, as well as a request for an amendment to authorize a large development plan in the northwest part of the field. Sonoma County would be lead agency under the CEQA for that development and would issue a use permit for the project.

Geothermal Prospecting Permit

Staff will closely monitor the efforts of Deep Rose Geothermal 16 LLC to initiate exploratory drilling on a 640-acre parcel in Inyo County covered by its geothermal prospecting permit.

Geothermal Applications and Competitive Leasing Nominations

Staff plans to review the environmental documentation and prospecting plans for the three applications for prospecting permits on school lands in the northern part of The Geysers and to recommend the CSLC issue those permits. Staff also intends to proceed toward a competitive bid lease sale for school lands in the Truckhaven area of Imperial County.

SOLID MINERALS PROGRAM

Mineral Lease Management

With continued diligent efforts, staff estimates revenue from school lands solid mineral leases may approach \$1 million in FY 2008-09 largely due to anticipated increases in aggregate production.

Staff will continue to work with Inyo County and the State Office of Mine Reclamation on reclamation issues before recommending the CSLC accept the quitclaim deed submitted by U.S. Borax for its lease (PRC 736) at the Gerstley Mine, though it is unclear when U.S. Borax will be able to meet the required performance standards for revegetation. Hanson Aggregates is experiencing steady sales at its Lakeside Quarry despite the housing downturn, and staff expects to recommend an extension and amendment of Hanson's lease (PRC

7301) in FY 2008-09 allowing for substantially greater royalties to the State. Although Western Mesquite Mines has resumed production following acquisition of new mining equipment, mining on the State lease (PRC 8039) is not planned to occur until 2010. With the assignment of the Sigma Stone lease (PRC 8253) at the Black Angel Mine to Vulcan Lands, Inc., production is expected to increase in FY 2008-09 and revenue should approach \$200,000. Protech Minerals' lease (PRC 8322) at the Pioneer Mine is likely to remain unproductive due to importation of inexpensive foreign talc. Granite Construction is hoping to return its lease (PRC 8272) at the Ludlow pit to production if it secures a contract to supply aggregate for repaving a portion of Interstate 40 west of Ludlow. Such a contract could provide the State about \$500,000 in royalty in FY 2008-09. Staff is hopeful Granite Construction's lease (PRC 7945) at the Palm Desert Pit can reach production levels achieved prior to the real estate downturn. Finally, staff will consider legal action if necessary to obtain payment from Jacobson Construction for the State's 1/16th interest in aggregate extracted from the Baker Pit.

Mineral Lease Applications

Staff will continue processing three lease applications that should result in new leases and increased revenues in FY 2008-09. Staff anticipates making a recommendation to the CSLC in fall of 2008 to issue a negotiated mineral lease to Hi-Grade Minerals adjacent to its Lucerne Valley Pit, with mining to commence in the second half of the fiscal year. Consideration of the issuance of a Negotiated Lease to Granite for the Liberty Quarry is not anticipated until the first half of FY 2009-10. This lease should provide in excess of \$100 million in royalties over the 50+ year productive life of the quarry. Staff also plans to continue working with San Bernardino County during the environmental review of BOR's proposal to reactivate its Manchester Quarry to provide rock to armor the levees of the Colorado River. Revenue from a State lease there could exceed \$5 million over the expected 25-year project life.

Mineral Exchange Application

Staff does not anticipate completing Kaiser's proposed mineral exchange during FY 2008-09. Kaiser has placed its application in abeyance pending appeal of the Federal District Court ruling regarding its land exchange with the BLM.

Mineral Prospecting Permit Applications

Staff plans to process the applications for mineral prospecting permits submitted by CPX and Victory, and any other new applications submitted as a result of the increased value of solid mineral commodities, particularly precious metals. However, staff expects aggregate to remain the most significant solid mineral commodity extracted from school lands, as there will be continued need for

aggregate for the home building, road construction and other infrastructure needs of California.

Abandoned Mine Lands

Staff will continue to work with OMR staff in an effort to inventory and remediate hazardous mine features located on school lands parcels. Numerous mine closures are planned during FY 2008-09 on parcels in the Mohawk Hill, Ship Mountains, and Cargo Muchacho Mountains. Inventory work will also continue, as will biologic and historic surveys, posting mine warning signs, and erecting fences around mine features as needed. Inventory and remediation work is expected to be complete by 2020. Efforts to inventory and close abandoned mines may be hampered by increased staff work to process the higher level of mineral exploration and development currently experiencing. Staff will strive to maximize results given these challenges.

OIL & GAS PROGRAM

Staff estimates revenue from the two school lands oil and gas parcels will reach \$600,000 during FY 2008-09, as oil prices are expected to remain strong.

FINANCIAL SUMMARY: FISCAL YEAR 2007-08

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$ 201,233.30
Geothermal	\$ 6,267,779.66
Solid Minerals	\$ 397,870.41
Oil and Gas	\$ 640,643.52
GROSS REVENUES	\$ 7,507,526.89

Less: Geothermal Resource Development Account (GRDA) Deposits.....	\$ <93,020.22>
(Public Resources Code Section 3826)	

TOTAL\$ **7,414,506.67**

EXPENSES: Net Management Costs

Land Management	\$ 278,771.92
Geothermal	\$ 548,055.49
Solid Minerals	\$ 232,724.94
Oil and Gas	\$ 2,802.17
Ownership Determination	\$ 79,140.33
GROSS EXPENSES	\$ 1,141,494.85

Less: Reimbursement Recovery	\$ <120,560.58>
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TOTAL EXPENSES\$ **1,020,934.27**

NET REVENUE TO STRS\$ **6,393,572.40**

SCHOOL LAND BANK FUND

Balance as of July 1, 2007	\$ 57,102,504.00
SMIF Interest Earned Fiscal Year 2007-08	\$ 2,530,138.21
Revenue from Land Sales	\$ 255,150.00
Less: Expenses	\$ <261,152.93>
Net Revenue to SLBF	\$ 2,524,135.28

BALANCE OF FUND AS OF JUNE 30, 2008\$ **59,626,639.28**

ABBREVIATIONS AND ACRONYMS

ASD	Appraisal Services Directorate, U.S. Department of the Interior
BLM	U.S. Bureau of Land Management
BOR	U.S. Bureau of Reclamation
CDPA	California Desert Protection Act
CDOGGR	California Division of Oil, Gas, and Geothermal Resources
CEQA	California Environmental Quality Act
CPX	CPX Uranium, Inc.
CSLC	California State Lands Commission
EIR	Environmental Impact Report
EIS	Environmental Impact Statement
FY	Fiscal Year
LLC	Limited Liability Corporation
LMD	Land Management Division
MRMD	Mineral Resources Management Division
NPS	U.S. National Park Service
OMR	California Department of Conservation Office of Mine Reclamation
PRC	California Public Resources Code
RFP	Request for Proposals
SLBF	School Land Bank Fund
SCP	Southern Clay Products
STRS	State Teachers' Retirement System
SVRA	State Vehicular Recreation Area

TNC The Nature Conservancy

USB U.S. Borax, Inc.